Weekly Commentary August 28, 2015

Fed Rate Hike Still in Play; Stocks Likely to Mark Time until Decision

Friday, 12:30 p EDT

The market volatility has increased speculation about whether the Fed will or will not raise interest rates at the September 17 meeting. James Bullard, whom I interviewed last Friday, was on Bloomberg news this morning from the annual Jackson Hole Fed confab reiterating his hawkish views. Bloomberg News also interviewed Narayana Kocherlakota, president of the Minnealpolis Fed, a well-known dove, who reiterated his strong concern about undershooting the inflation target. Loretta Mester, president of the Cleveland Fed, was, in my opinion, surprising hawkish. None of these is a voting member on the FOMC this year, but I would not be surprised that no matter which way the Fed goes next month, there will be at least one dissent from the stated policy.

Nevertheless, there are still almost 3 week until the next meeting and much can (and will) happen. If markets (including Chinese) stabilize and economic data comes in strong, tightening is definitely back on the table. Despite the very strong Q2 GDP number yesterday, Q3 GDP growth is running in the low 2s, very near the rate of the first half (now at 2.1%), and below the 2.5% rate of 2014. Inflation is running well below target, as todays core PCE, the most important Fed indicator, coming in at up. 0.1% in July and running year-over-year at only 1.23%. Of course, we should note that in the last 30 hours, we have had an extraordinary rally in oil, with WTI now selling at $45, nearly 20% above the low of $37.75 set on Monday. But even with this surge, gasoline prices are set to decline, as temporary regional shortages have artificially kept national gas prices high. (Indeed I bought gas in New Jersey yesterday at $2.169/gallon, 36 ½ cents below the national average, about 20 cents more than the average Jersey discount and the evening news reported some stations under $2.00).

A pure chartist would claim that stocks will probably test (come within 1% to 2%) of their lows before forming a base to move substantially higher. Honestly, I would be surprised if stocks make much more upward progress before the September meetings. If financial and commodity markets calm, I can see a good rally in the fourth quarter after the Fed acts, no matter what that action is. The pace of tightening is far more important than when it begins and even Bullard has conceded that this pace will be slow. Stock traders focus will then shift to earnings and whether firms' profits can recover from the decidedly lackluster 2015 results posted so far.

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